

UNPAID IMPORT SUPPORT LOANS: What Can Be Done?

Background

1. Since 1986 approximately TSh 200,000 million in balance of payments support finance has been lent to enterprises and approximately Sh 25,000 million paid back. (The total amount at exchange rates prevailing when the imports were made is probably of the order of \$850-1,000 million.) The 1980-86 data are still being reconstructed. However, they may total \$125 million at an average current exchange rate of - say - 22 or TSh 2,750 million gross (repayments unknown).
2. At current exchange rates the total due is of the order of TSh 350,000 million (equivalent to the 1992/93 budget) for 1986-92 and perhaps TSh 375,000-400,000 million for 1980-92.
3. Since early 1992 a new system - via the BOT - has been in operation which should avoid further build-up of arrears and preserve the cash flow to the Budget of counterpart TSh from import support finance sold to enterprises. That, however, does not resolve the problem of the overhang.
4. A Bill exists to require prompt repayment at the exchange rate on the date of repayment (not of drawing). On paper that would solve the problem but - even if only because of liquidity results - is most unlikely to prove a simple way either to recover the Treasury's funds or to avert chaotic enterprise and production difficulties. The issues are not equity or justice - on those grounds the Bill is justifiable - but practicality and side effects.

History Of A Disaster

5. Import support funding sold to enterprises did not begin in 1980. Before it was concentrated on one continuing flow and a one-off (but several year) exercise:
 - a. food aid usually on sold to NMC;

- b. goods imported and sold (to STC but also other parastatals) to finance the local cost of Tazara.
6. Cash on delivery was never seen as a totally practicable method of payment - at least after 1971 and the introduction of bank credit ceilings and allocations. In principle the Treasury agreed that 90 to 180 day interim commercial credit to the purchasing enterprises was acceptable. There was never a consensus on implementing interest albeit the prevailing view was that normal overdraft rate should be charged for the agreed 90 to 180 days and higher penalty rates thereafter to discourage using de facto Treasury loans to replace bank overdraft when the latter was available. In respect to the two areas of major concern the purchasing enterprise would normally have resold within 90 (and certainly 180 days) and should have been in a position to repay.
 7. In the case of food aid while delays and innumerable quarrels over quantity and valuation arose by and large through 1980 NMC repaid the bulk of its debts to the Treasury into a special account (or accounts) at the BOT. In practice it does not appear to have paid interest. NMC over that period did have access to additional overdraft facilities so when pushed by Treasury probably could and did borrow from NBC to clear its books on food aid imports.
 8. The Tazara case was more interesting - not least because the Treasury avoided getting into the commercial banking business and because by and large the loans were repaid on time. The operation was carried out by the BOT (who handled the loans and the recoveries into Tazara local cost account) on behalf of Treasury. This worked smoothly, so smoothly it seems that by 1980 no one remembered it. (Presumably the accounts were closed by 1976 or 1977 with completion of Tazara.)
 9. In 1980 general import support and commodity aid for resale beyond food aid and drugs again became of at least secondary importance albeit the main upsurge comes from late 1986 (the first SAP). The question of how to handle these sales arose and was sent for analysis/proposals to the then Economic Advisor, probably in April.
 10. The proposal made which was in principle agreed by MF and PST was:

- a. allocation of import capacity to enterprises within the overall import budget exercise;
 - b. payment on arrival if the purchasing enterprise was not at its NBC credit ceiling;
 - c. credit of 90 to 180 days (preferably at overdraft rate) to enterprises unable to finance within NBC credit ceilings;
 - d. operation of sales-credit advances-recoveries by the BOT analogous to Tazara local cost finance/Chinese goods import exercise.
11. The reason for "c" was simple. The bank credit allocation policy (Annual Credit Budget) was strict and was fashioned to limit inflation. Additional imports were seen as a means to increasing output and as generating only a self-liquidating credit requirement which in a real sense was matched by the imports and thus was not inherently inflationary. To block use of the import support to stay within credit ceilings would, therefore, be unsound policy and, on the other hand, to expect NBC to run a parallel allocation system (one for basic bank credit and one for import support purchases) was viewed as likely to lead to hopeless confusion and to open opportunities for fiddling on the basic ceiling.
12. Most unfortunately the consensus position was not merely not implemented; both it and the problem were lost to sight for a decade! How or why the initial inaction happened is unclear - probably time pressure to July from the Budget, to late in the year from (unsuccessful) attempts to get a World Bank programme in place and to keep the Fund one alive buried it. (And the Economic Advisor left in September so was no longer there to re-raise issue.)
13. What did happen was a travesty of normal Tanzania Treasury procedure and monitoring:
- a. External Finance made the advances (and apparently many of the allocations to enterprises at least after 1986);
 - b. External Finance has no accounting capacity and instead of requisitioning some and keeping a consolidated ledger of advances, due dates, repayments (and a separate up-to-date page for each

borrowing enterprise) seems to have recorded haphazardly in various files and individual transaction notes;

c. External Finance did not provide data to the Accountant General as a matter of course so no consolidated overall record and few (if any) enterprise records existed there;

d. Accountant General's failed to call for the data, to set up a system or to include an account of import support finance loans, recoveries, balances on its regular reports to MF, PST and Dpty. PS-Policy;

e. As a result MF, PST, Dpty. PS-Policy never had the mounting problem called to their attention, neither specifically by External Finance or Accountant General nor by noting the rising balances (low recoveries) on a statement of account;

f. And Dpty. PS-Policy had a limited staff fully tied down on issues which were put to him so did not uncover the growing overhang in any general review exercise.

14. The issue surfaced from 1989 on largely as a result of donor queries as to uses made of the counterpart funds from import support (which except for food aid were largely tied up in non-recovered loans). At the same time the huge discrepancy between Import Support received and sold and counterpart funds available therefrom began to become evident to MF, PST, Dpty.Secty.-Policy.

15. As a result in 1991-92 MF directed Dpty.Secty.-Policy to carry out an exercise on what was happening, where the money had gone and how much was owed.

16. This resulted in:

a. identifying the chaotic non-process that had led to the overhang;

b. rough data or credits outstanding (rough because the records were so very bad that both advances and recoveries may yet remain to be identified) since 1986;

c. a new system analogous to Tazara one (and the unacted on 1980 proposals) via the BOT to get a firm hold on future credit flows, recoveries and (new) outstandings.

17. This record sheds no credit on anyone: Treasury, enterprises, BOT (whose analysts should have called Import Support Sold/Counterpart Funds deposited discrepancy to Treasury's attention by 1986 at the latest) or Auditor General's (who should have made the same discovery somewhat earlier). The haphazard non-procedures of External Finance and lack of insistence on/creation of proper records by Accountant General's represent virtually incredible absent-minded negligence. (Corruption is not the basic problem. With the opaque non-system some enterprises may well have bribed some officers, but simple systemic negligence accounts for most of the unrecovered advances and created the context in which malfeasance was easy to commit and to hide.)
18. The sum total outstanding demonstrates just how huge and appalling the oversight (in the sense of overlooking, not of overseeing!) was. It is as if 10% of total receipts (or - say - all income tax) had been 'misplaced' annually for a decade. No even vaguely comparable procedural breakdown has ever afflicted Hazina (thank God!).

What Now? The Blocked Road

19. At first thought the present agenda seems clear "Make them pay up". The enterprises had the goods, sold them, used the proceeds, paid no interest, so are morally obligated to pay - legally as to principal and morally as to interest or exchange rate 'fluctuation'.
20. The present Bill proceeds on those lines. In theory it should result in Sh 350,000-400,000 million old loans pouring into the Exchequer over - perhaps - 6 to 18 months. The 1992/93 Budget deficit would be wiped out, Government bank borrowing radically reduced, room made within credit ceilings for additional NBC lending.
21. Unfortunately that is a daydream. A nightmare scenario is more likely to unroll:
 - a. The Bill becomes an Act in June;

- b. Treasury demands TSh 350,000-400,000 million from 190 to 200 companies (over 80% of all large and semi-large public, joint venture and private enterprises);
- c. Perhaps 10 can pay in full within 3 months and another 15 within 12 months;
- d. The balance are either not liquid (assets exist but not cash) or insolvent (the assets are less than the liabilities including the recalculation of import support advances at current equivalent of initial foreign exchange used);
- e.-1. The Treasury puts in receivers and managers ending trying to run almost the whole large enterprise sector (including the joint venture and private sub-sectors);
- e.-2. The Treasury squeezes companies getting some money but - as this depletes their working capital and they have little or no access to NBC overdraft boosts - also forcing them to cut back operations creating both direct loss of output and chaos;
- e.-3. The Treasury discovers what trying to collect in cash promptly would mean and backs off looking exceedingly ineffective and raising massive suspicions of corruption at home and of total incompetence and powerlessness abroad.

22. Tanzania has to do better than that.

Where Has The Money Gone?

23. The enterprise did receive the imports and sell them. Therefore, at that stage they should have had the cash to repay. What has happened to it since? The probable answers are complex and the balance varies from enterprise to enterprise:
- a. the cash flow was used to meet losses - particularly but not only in the case of parastatals;
 - b. the cash flow was put into working capital or (less likely) fixed investment either because other borrowing options did not exist and/or because 0% borrowing is preferable to 20%-35% from the borrower's point of view;

- c. the enterprise had external assets (from outward smuggling) which it would (especially after 1984 when "own forex" imports were legalised and largely exempted from import licensing) have used for imports and used the import support credits to keep/invest that forex abroad - almost totally a private or foreign managed joint venture phenomenon.

24. Both the moral and the economic (recoverability) implications of a-b-c diverge:

- a. morally using loans to meet losses without making the problem plain to creditors and shareholders is wrong. It is also an offence under the Companies Act especially if the enterprise is in fact bankrupt. But in the case of parastatals at least the Government has condoned such action as a means to avoiding economic disruption from mass liquidations (e.g. several Marketing Boards, Co-op Unions) so prosecutions seem a rather implausible course of action, except in one set of cases - failure to record the loan as a liability. That is theft via fraudulent accounting. In those cases the Executive Chairman, General Manager and Chief Financial Officers at the relevant dates should be charged with theft/fraudulent accounting and probably the Directors with failure to fulfil their duties of due care and diligence. Further, the Auditors (if they passed the accounts) should be required to explain how they failed to detect the fraud. This applies to private as well as public enterprises and to private sector auditors as well as TAC. (If TAC gave the books what it then called "no opinion" - i.e., no books! - or heavily qualified report that is a good answer.)
- economically money that has been lost cannot be recovered, at least if the net assets are negative. Whether to put a parastatal, a joint venture or a private enterprise into liquidation, into receivership or into negotiating a partial (phased) repayment requires case by case studies:
 - i. how much can be recovered how fast by - a) liquidation, b) keeping going under reformed management?

ii. what harm to other enterprises, workers, the economy would result from sudden liquidation?

iii. how fraudulent (as opposed to negligent or naively optimistic) was the enterprise's action?

b. morally not repaying loans is wrong even if the funds are used productively. But the original arrangements were so haphazard, the calls for repayment so few and far between and the incentive of using easy to get/keep 0% money instead of hard to get/20% to 30% money so great it is hard to make out a strong case. Requiring repayment at current exchange rate (or with cumulative interest at prevailing overdraft rates from date of borrowing) would seem adequate.

■ economically this is the most hopeful case. If the funds have been used productively assets exist to cover at least the initial face value of the loan and presumably profits on them would cover all or part of the uplift from adjusting to present exchange rates.

But:

- unless the enterprise has massive unused overdraft facilities, cash on deposit or Treasury notes (unlikely) it cannot repay in cash without reducing the scale of operations or refinancing. It is no use saying "serves you right" if the results in terms of production and damage to other enterprises and workers are severe. In such cases 20% interest, 1 to 10 year notes (i.e., 1/10 retired each year) might well be feasible as internal cash flow plus refinancing could cope over that period;
- but the radical revaluation (increase) of debt would logically be a capital loss allowable against future operating income liable to company tax because profits made on the assets received from loan were taxed on basis of original amount in TSh of loan. Losses on forex rate changes are usually allowable and that is de facto what the Bill would impose. Normally such losses can (must) be used as soon as possible but, in return for 10 years to repay, Treasury could require enterprise to offset the capital loss against taxable income over ten years (1/10 a year).

- c. morally the diversion of (probably originally illicit) forex flows to overseas uses is wrong. It is (or was at the relevant times at least) criminal in nature. Whether a wave of prosecutions would be wise is another matter. First, proving the overseas assets will usually not be easy and enforcing their return harder. Second, if a large number of major enterprise figures are prosecuted the impact on private sector confidence (and on that of foreign enterprises dealing with them or us) needs to be considered.

In theory an enterprise could have had openly acquired funds abroad which it did not repatriate but declared in accounts. In that case no moral blame applies. Given the nature of the exchange control regime, this would appear to be an unlikely case albeit after retention accounts were introduced (keeping forex legal albeit 'onshore') it may have happened in a few instances.

- Economically there is a chance of recovery if the enterprises' owners (these are private sector cases) value their local enterprises, and the serious threat of seizure of enterprise assets and/or of prosecution causes them to repatriate overseas assets. In such cases the realistic route is to settle for: a) an injection of new assets as equity by owners, b) a phased repayment and phased forex loss offset against taxable income scheme like that for companies which used assets in Tanzania but preferably on less generous time terms.

25. While at present the division of 'uses' of funds is anybody's guess it seems likely:

- a. (losses) are 33% to 60%
- b. (used in Tanzania) are 30% to 50%
- c. (de facto used abroad) are 10% to 15%.

That implies potential recoveries of 35% to 65% phased over 10 years (70% to 130% of face value of loans in TSh at date of issue).

Problem Areas

26. In respect to an enterprise which can repay over 10 years with interest without crippling its ongoing activity no problem - other than preparing documents and monitoring payments (in Government Loans section of Accountant General's or by BOT as banker's to government so job gets done this time) - arises.
27. In respect to an enterprise which even excluding this debt is a bankrupt firm in a different sense no new problem arises. The enterprise has to be liquidated, its assets sold to a new owner and a settlement arranged on liabilities (including the new one) or a capital reconstruction undertaken with new resources injected to secure a return to viability. The debt - as set out in Bill - can be entered on the books but collection deferred to time of liquidation or write-off/conversion to equity handled as part of the reconstruction exercise as the case may be.
28. The problem cases are enterprises which are:
 - a. solvent and liquid before taking the debt into account;
 - b. operating at a profit excluding interest on the debt;
 - c. but would be insolvent if the full debt were put on the books at current exchange rates and/or could not retire it with interest over ten years.
29. In such cases forcing insolvency leading to liquidation or creditor (probably Treasury as largest creditor and the main defaulted one) seizure of the enterprise makes little sense:
 - a. it is serving an economic function;
 - b. liquidation will probably yield lower recoveries than a compromise settlement;
 - c. Treasury seizure under a receiver/manager is likely to lead to disruptions and lower efficiency of operation as well as (since much of the large/medium scale private sector is likely to be affected) horror on the part of the World Bank and foreign investors and panic by domestic entrepreneurs.

30. The least unsound way forward would seem to be:

- a. assessment of what interest/debt repayment burden enterprise could meet over ten years consistent with continued viable operations;
- b. putting that portion of import support drawings into 20%, 1 to 10 year notes (as with full repayment enterprises);
- c. also requiring (as a condition for not enforcing immediate payment) all shareholders - other than government, NBC, TDFL, TIB and perhaps genuine third party shareholders who did not know about 'loan kiting' - to convert their loans to enterprise into equity at par (many private enterprises have substantial loans from directors and other major shareholders).

31. The above is the pattern of reconstruction used by creditors (e.g. banks) for viable companies crushed by debt overhang. They get part of money on a phased basis and - to extent enterprise recovers - a chance at getting rest when they sell shares.

32. The Treasury should put the shares acquired into:

- a. a trust fund separate from main Treasury Registrar holdings;
- b. managed for it by TDFL or TIB on contract;
- c. using dividends to cover management costs (contract could be low basic fee plus 50% of dividends up to \$500,000; 10% on next \$2,000,000; 5% thereafter);
- d. selling off shares to local investors (including NIC, NPF, Diamond Jubilee, etc.) when most of debt portion had been cleared and share value recovered.

33. Fine tuning to make debtors other than Treasury and shareholders also holding debt pay part of cost (by conversion to equity) is undesirable:

- a. takes time to negotiate and neither time nor personnel are plentiful;
- b. the independent creditors are largely "innocent bystanders" who have a reason to be aggrieved at Hazina for not recording,

publicising, recovering import support loans promptly. The largest - NBC - can hardly afford yet more bad debts which - in the end - Treasury will have to cover one way or another.

Procedural Aspects

34. This is by no means just a Treasury asset recovery issue. It is an overall policy issue because chaos or closure in respect to most large and semi-large enterprises would be a macroeconomic disaster.

35. Therefore a working group is needed:

- a. Planning;
- b. Commerce and Industry;
- c. Treasury;
- d. A parastatal figure not personally involved in past borrowings.

36. At top level group could be:

- a. Minister of State (Chairman)
- b. Minister
- c. Minister
- d. Chairman NDC

and at official

- a. Deputy Secretary-Policy (Chairman)
- b. (Designated by Minister)
- c. Deputy Secretary-Policy
- d. NDC or TIB Chief Financial Analyst

plus

- e. Chief Executive Tanzania Audit Corporation
- f. Research Director BOT

37. The official working group (on the basis of a terms of reference/guidelines decision by top level group) would:


- a. review situation enterprise by enterprise;
- b. propose action on enterprises in respect to which position was clear;
- c. advise TAC audits (under "Special Audit" provisions) be ordered where position in doubt;

- d. subject to guidance and approval by top level working group, negotiate part debt/part equity solutions where appropriate.

38. In this case there is a deadline for:

- a. agreeing approach;
- b. making it public;
- c. having enough data to know what implications in terms of cash recoveries and time period, equity received, irrecoverable.

And that is Budget Speech. To avoid uncertainty and panic a clear statement of how to proceed is needed.



RHG
Falmer
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To: Hon. S. A. Kibona, Planning Commission
Hon. C. D. Msuya, Commerce and Industry

Copied: Dr. S. Kipokola, Planning Commission
Al Noor Kassum, NDC